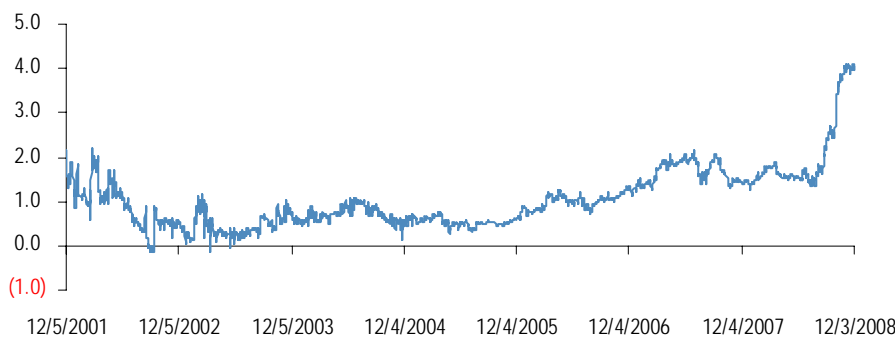


India Equity Strategy

Color of Money

- Institutional selling continues:** Over November, the intensity of foreign institutional investor (FII) selling abated. However, local mutual funds turned sellers, pressuring the markets. YTD among FIIs, while international and global emerging market funds have been meager buyers, they have been swept aside by Asian and country-dedicated funds.
- Key sentiment indicators remain weak:** Trading levels in the cash markets and outstanding positions in both stock and index futures hit new lows for the year. Implied volatility (Nifty & S&P500) and EMBI spreads remain at uncomfortably high levels. Insider activity remained negligible, too. Our money flow monitor indicates inflows into IT services and Financials.
- Government bonds rally:** Over the month, the yield curve shifted south by nearly 50-70bp across maturities. Yields on the 10-year currently at 6.8% are at a three-year low. J.P. Morgan expects the benchmark repo rate to be cut aggressively by another 250bp over 2009.
- Special focus: Credit market cues.** Despite the RBI cutting the Repo rate by 150bp and the CRR by 350bp, credit markets remain stressed due to the lack of risk appetite. While equity market valuations are near trough levels, we maintain our view that a sustainable rally herein would have to be preceded by an improvement in credit market conditions.

Corporate bond spreads – Low risk appetite



Source: Bloomberg, J.P. Morgan

Note – Spread is between five-year AAA corporate bond and treasury yield

India

Market Strategy

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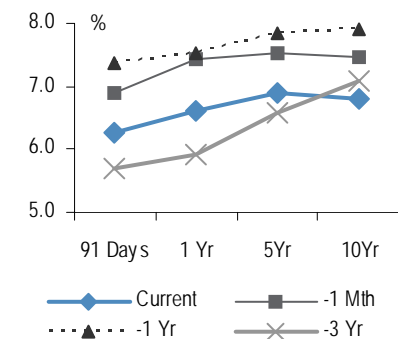
Emerging and Asian Equity Strategy

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J.P. Morgan Securities (Asia Pacific) Limited

Yield curve – Accelerated downshift



Source: Datastream

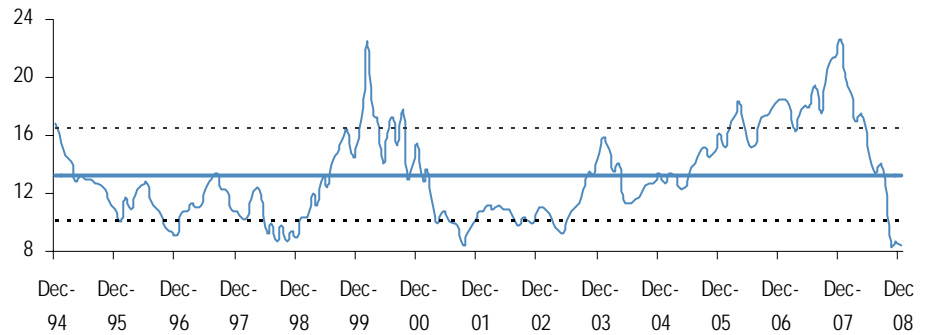
See page 16 for analyst certification and important disclosures, including non-US analyst disclosures.

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Special Focus – Credit market cues

The equity markets are currently trading at historic trough levels, even after accounting for the considerable uncertainty in the growth outlook over the near term.

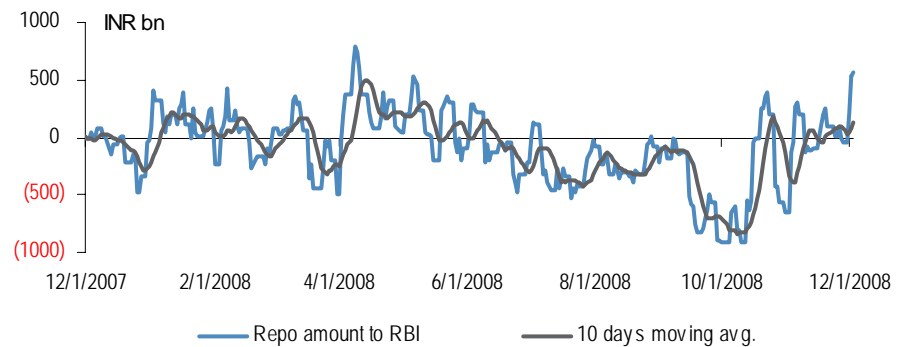
Figure 1: MSCI India 12-month forward P/E



Source: IBES, MSCI, Datastream

Markets are, however, likely to pick up in a sustained manner only after the credit markets improves, in our opinion. Despite the RBI beginning to ease monetary policy (the repo rate has been cut by 150bp and CRR by 350bp), credit markets remain stressed due to lack of risk appetite in the financial system.

Figure 2: Improved liquidity situation in the Indian banking system

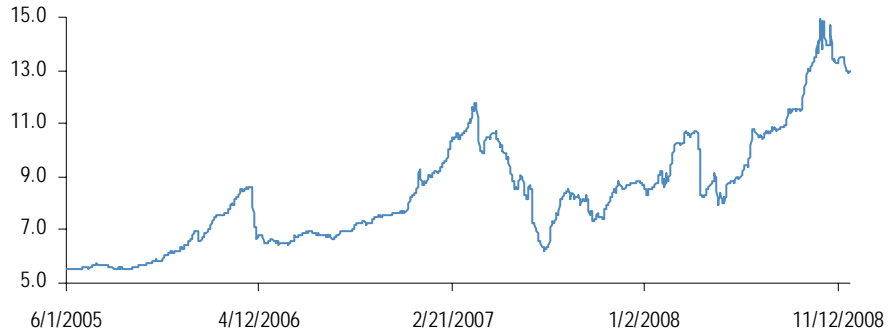


Source: Bloomberg

Below, we present the key indicators that we would be monitoring to gauge an improvement in liquidity and sentiment.

CP rates have come off peak levels but remain substantially higher compared to the long-term average

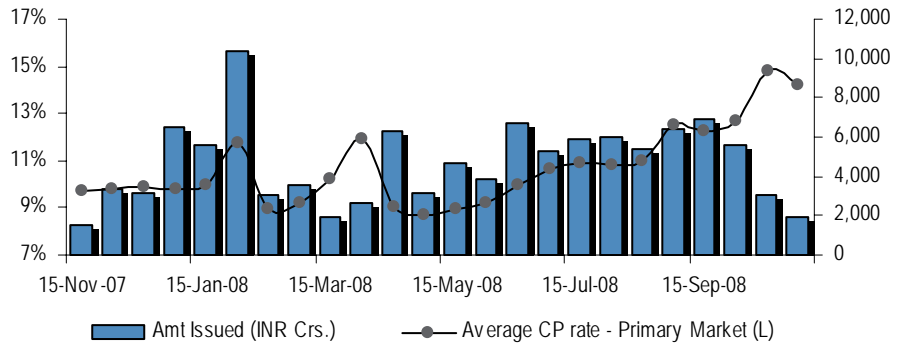
Figure 3: Three-month Commercial Paper (CP) rates



Source: Bloomberg

Availability of funding to companies through CPs has reduced significantly. Anecdotal evidence, however, suggests a marginal improvement over the last fortnight

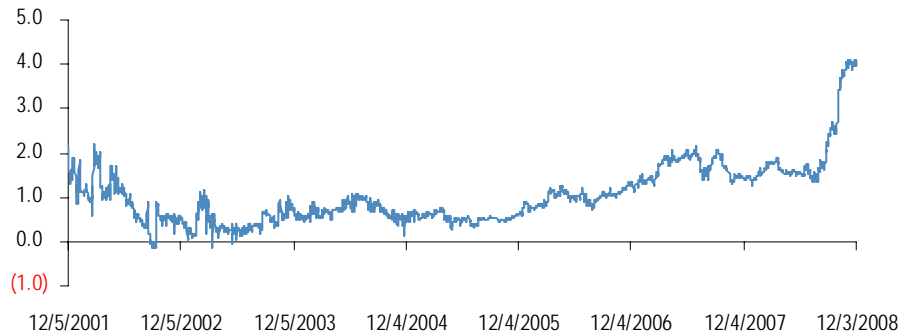
Figure 4: Commercial paper issuance and primary market rates



Source: RBI

The spread between 5-year corporate bonds and Treasury remains at decade highs

Figure 5: Corporate bond spread

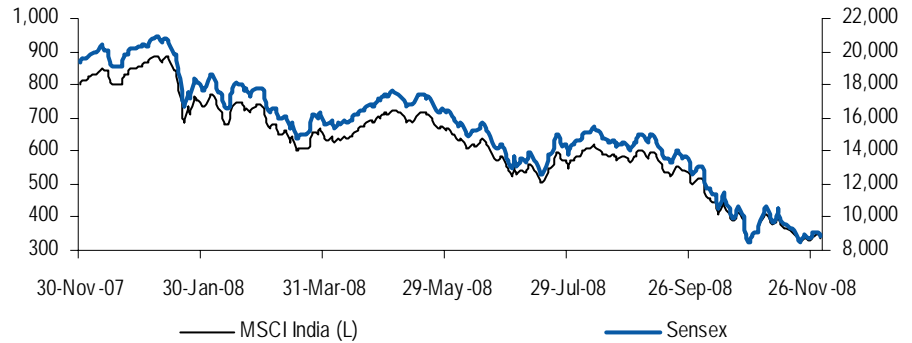


Source: Bloomberg, J.P. Morgan calculations.

Market performance

Figure 6: BSE Sensex and MSCI India

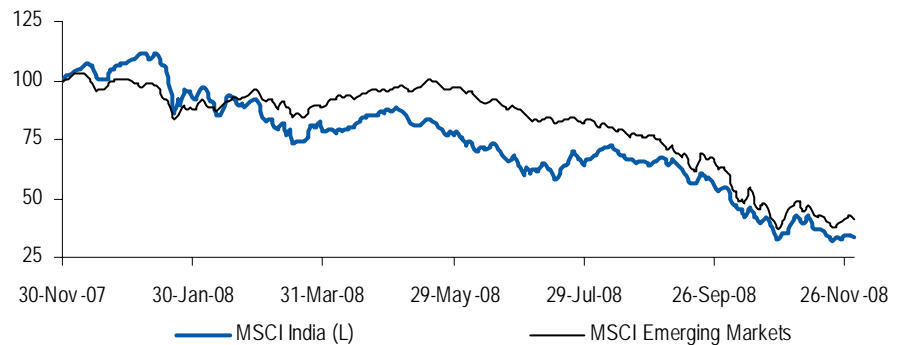
The MSCI India Index continues to trade at the lower end of its recent trading band



Source: Datastream.

Figure 7: India vs. emerging markets

Indian equities underperformed emerging markets over the month. MSCI India Index (US\$) lost 19% (vs. a loss of 14% for MSCI EM (US\$))



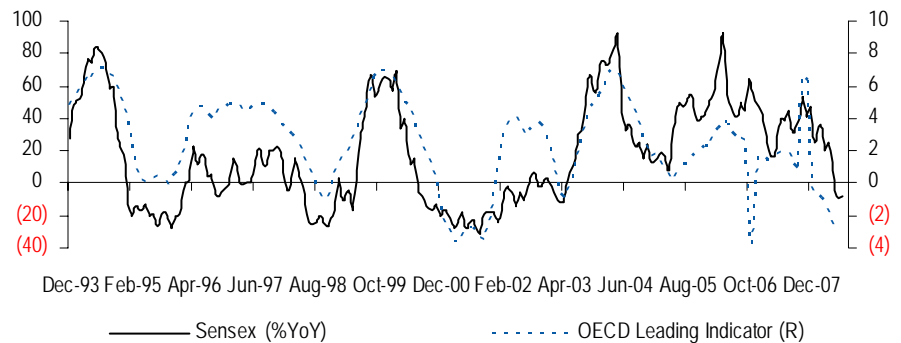
Source: MSCI, Datastream. Note: Rebased performance of MSCI US\$ indices.

Figure 8: OECD composite leading indicators and Sensex

September 2008 data indicate a continued weakening outlook for all seven of the major economies

The latest data for major non-OECD member economies tentatively point to a downturn in China and a slowdown in Russia and India

The CLI for India fell by 1 point in August 2008 and was 6.6 points lower yoy

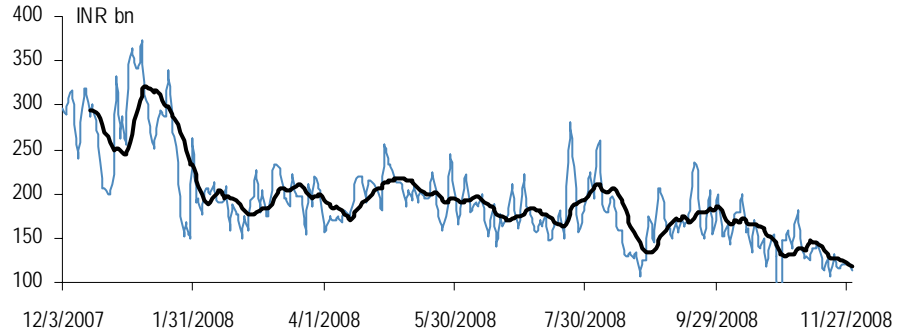


Source: J.P. Morgan Economics, Datastream.

Summary of investor activity

Traded value in equity markets reduced further over the month

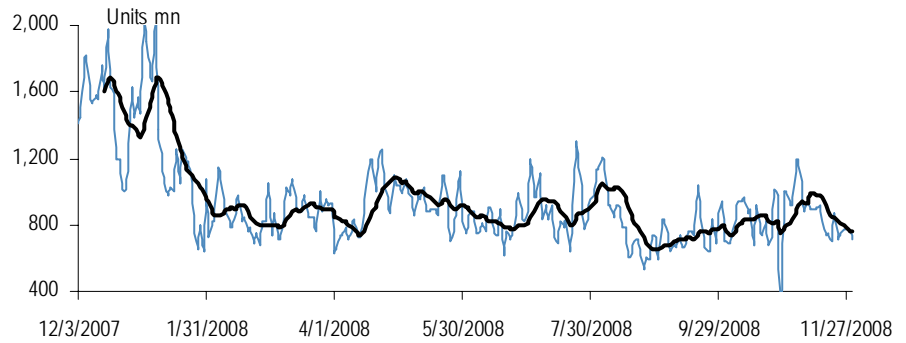
Figure 9: Trading value - Cash market



Source: Bloomberg. Note: Aggregate turnover of NSE and BSE. Bold line is 10-day moving average.

Trading volumes, however, picked up due to higher activity levels in mid and small caps. Note that small & mid caps marginally outperformed large caps over the month

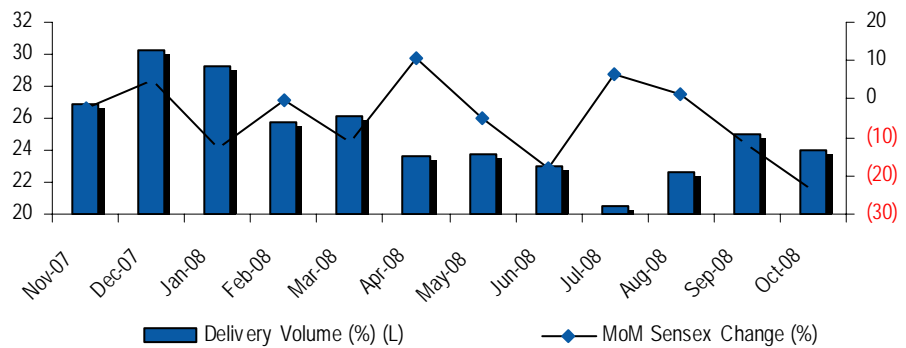
Figure 10: Trading volume - Cash market



Source: Bloomberg. Note: Aggregate turnover of NSE and BSE.

Delivery volumes decreased marginally over October

Figure 11: Aggregate delivery volume (Percentage of total cash volume traded)

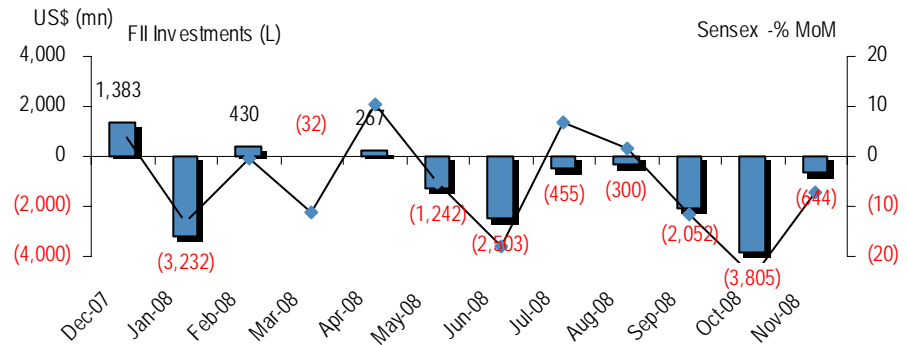


Source: NSE, BSE.

Foreign Institutional Investor (FII) activity

FII remained net sellers over November and sold equities aggregating US\$644MM
YTD, FIIs have sold US\$13.6B of Indian equities

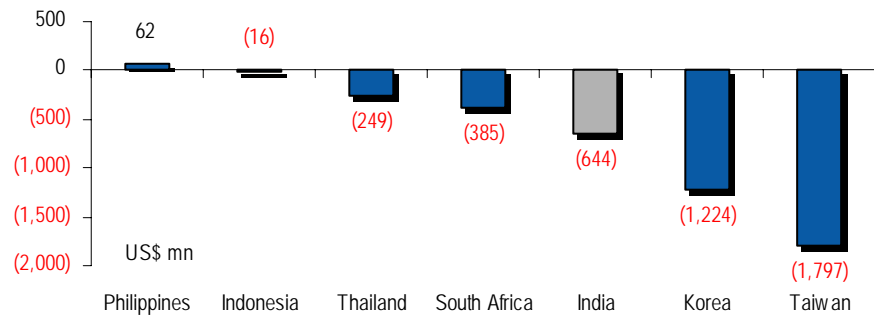
Figure 12: FII investments and Sensex



Source: Datastream, Sebi.

Figure 13: Key emerging markets and FII flows – November

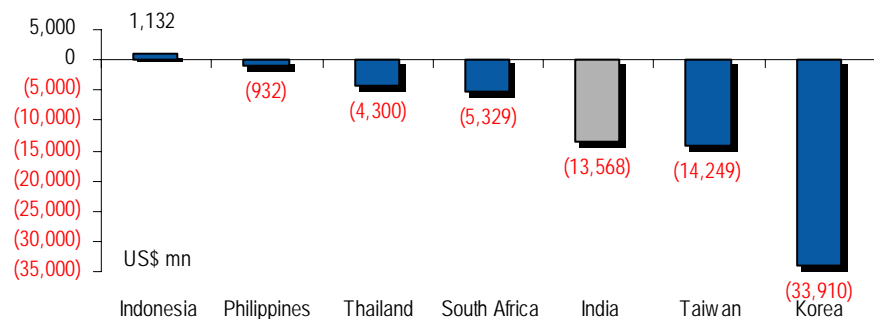
FIIs were sellers of equities in key EMs



Source: Bloomberg.

Figure 14: YTD 2008 FII net flows

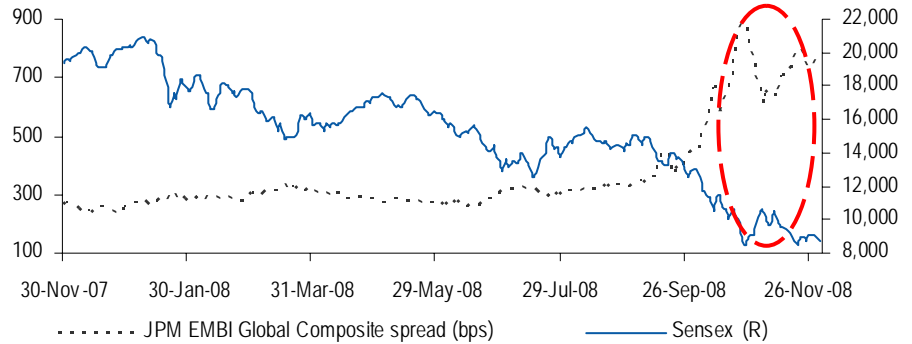
YTD, most emerging markets have seen outflows



Source: Sebi.

EMBI spreads widened over the month
Higher EMBI spreads typically indicate lower risk appetite and is not conducive to EM outperformance

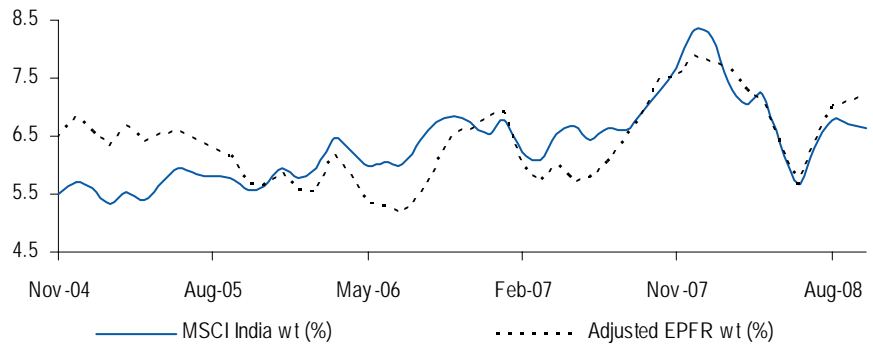
Figure 15: EMBI spreads and Sensex



Source: Datastream.

Last available EPFR data for October indicates that foreign investors are marginally overweight on India in the emerging market context

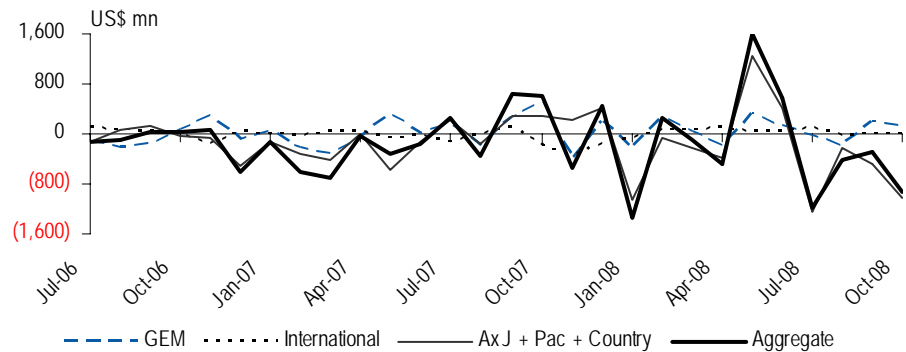
Figure 16: India weight in MSCI and EPFR universe (%)



Source: MSCI, Datastream, EPFR.

Most fund styles were sellers over October, except GEM funds

Figure 17: International flows into India and fund style



Source: EPFR.

J.P. Morgan expects further monetary easing in India over 2009. The repo rate is expected to be lowered to 5.00% by Dec 2009.

Our economics team expects a zero interest rate scenario in the US over 2009

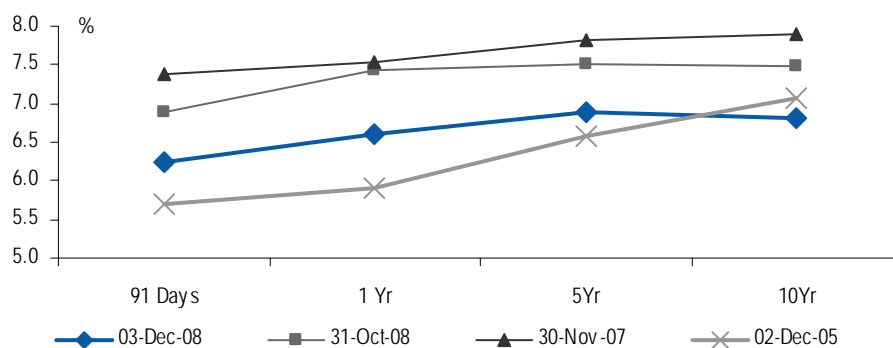
Table 1: Global interest rate trend

(%)	Dec-06	Dec-07	Current	Dec 08 (E)	Dec 09 (E)
US	5.25	4.25	1.00	0.50	0.00
Japan	0.25	0.50	0.30	0.30	0.10
Euro	3.50	4.00	3.25	2.50	1.00
India	7.25	7.75	7.50	7.50	5.00

Source: J.P. Morgan Economics.

The yield curve shifted south meaningfully as the RBI cut benchmark rates & reserve requirements

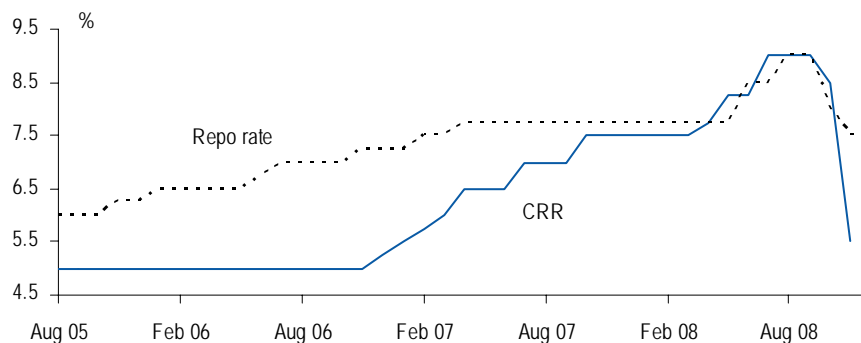
Figure 18: Indian yield curve



Source: Datastream.

The RBI has cut the CRR aggressively by 350bp to overcome tight liquidity conditions. Also, the repo rate has been reduced by 150bp

Figure 19: Cash reserve ratio and repo rate



Source: J.P. Morgan Economics.

Money flows monitor

Table 2: Money flows – November

Outflow	Inflow
Indiabulls Financial Service	Satyam Computer Services Ltd
Aditya Birla Nuvo Limited	Glenmark Pharmaceuticals Ltd
Indian Hotels Co Limited	Housing Development Finance
State Bank Of India	ICICI Bank Ltd
Tata Communications Ltd	Hindustan Unilever Limited
Dr. Reddy's Laboratories	Tata Consultancy Svs Ltd
Glaxosmithkline Pharmaceutic	Infosys Technologies Ltd
Steel Authority Of India	Kotak Mahindra Bank Ltd
HDFC Bank Limited	Bharat Heavy Electricals
Tata Steel Limited	Infrastructure Dev Finance

Source: Bloomberg. Note: Money flow is sum of daily trade volume. * Daily price change.

Over the last month, money flow across sectors was mixed. The IT sector appears to have seen inflows, though

Table 3: Foreign holding – MSCI India sectoral trend

(%)	Mar-07	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08
Consumer Discretionary	44.1	40.4	41.5	44.0	49.9	49.7	50.0
Consumer Staples	52.8	51.5	52.2	50.0	54.9	52.2	53.1
Energy	15.9	16.7	17.8	20.6	17.4	19.2	17.1
Financials	50.4	44.7	45.3	36.1	37.7	37.6	36.3
Health Care	33.1	32.6	30.7	27.2	28.0	27.5	26.5
Industrials*	33.2	31.2	30.4	27.5	26.4	25.3	24.4
Information Technology	27.4	27.6	28.8	29.2	36.9	32.1	31.2
Materials	27.8	29.2	29.3	42.0	32.8	32.3	28.8
Telecoms	14.1	13.6	12.6	12.4	11.9	12.1	11.2
Utilities	20.9	20.9	21.2	11.1	10.1	9.2	8.6

Source: NSE, MSCI, Datastream.

Over July to Sept 2008, FIs increased their holdings in Consumer Discretionary and Consumer Staples, while they reduced their holdings in the Materials, Energy and Financial sectors

Table 4: Stocks with significant changes in foreign ownership (July - Sept 2008)

	Higher holding	Reduced holding
1	Reliance Capital	Ranbaxy Labs.
2	Glenmark Pharmaceuticals	Infr. Dev. Finance Co.
3	TCS	Sterlite Inds.(India)
4	Maruti Suzuki	Axis Bank
5	Hindalco Industries	Indiabulls Real Estate
6	Mahanagar Tel. Nigam	Abb
7	Bhel	ICICI Bank
8	Kotak Mahindra Bank	Jaiprakash Associates
9	Sun Pharmaceuticals	Bharat Petroleum
10	Ambuja Cements	Tata Iron & Steel

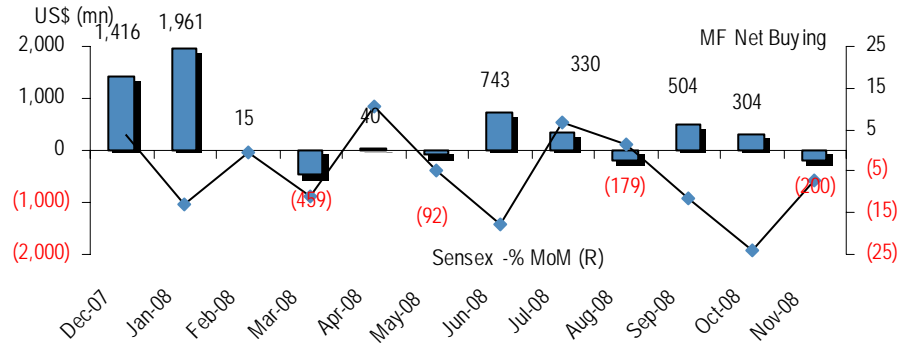
Source: NSE, MSCI, Datastream.

Domestic institutional investor activity

Local mutual funds turned net sellers of equities over the month.

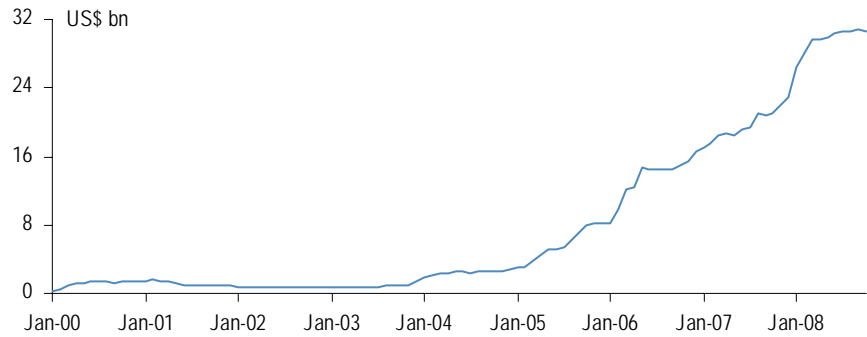
YTD, domestic mutual funds have invested US\$3.0B

Figure 20: Domestic mutual fund buying and Sensex



Source: Sebi, Datastream.

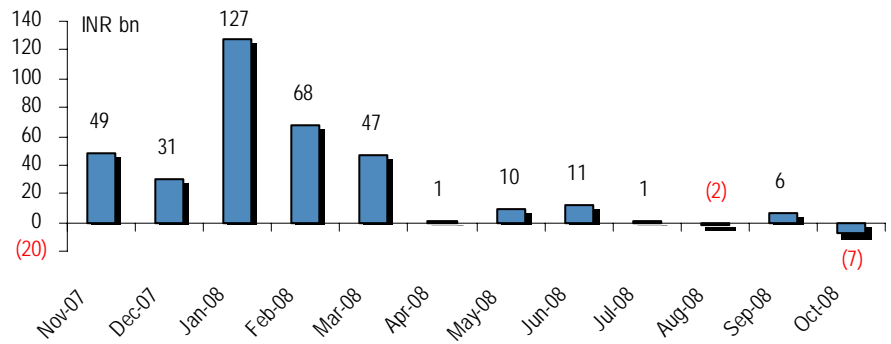
Figure 21: Cumulative equity mutual fund subscription



Source: AMFI.

Inflows into equity MF schemes remain weak

Figure 22: Net subscription – Equity funds*



Source: AMFI. Note: Chart for growth fund only.

The rate of growth of first-year premia collected by the life insurance sector has been decelerating over the recent past

Higher growth reported over September is due to a low base effect for LIC

Private sector players continue to report relatively strong growth, 49% for April to September

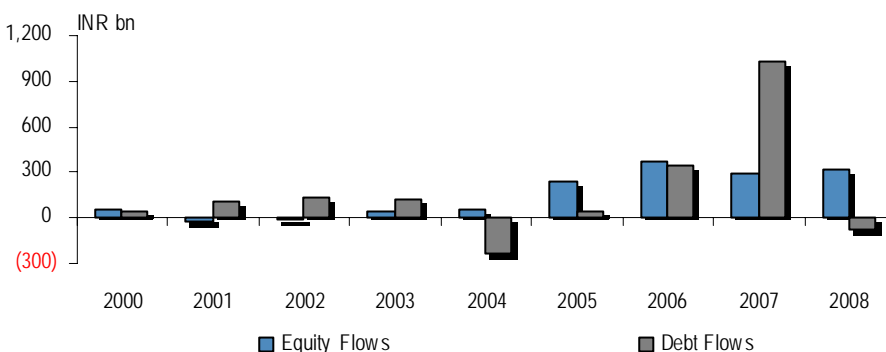
Table 5: Life insurance premium and estimated investments in equities

INR in millions		Sep-08	Aug-08	Jul-08	Jun-08	May-08	Apr-08
LIC		47,314	35,629	32,725	33,537	29,230	12,479
Private Sector Cos		34,168	27,106	25,859	28,476	24,162	15,322
Industry		81,482	62,736	58,584	62,013	53,392	27,801
	(YoY growth)	56%	-22%	-20%	20%	23%	-7%
		FY 09 YTD + 4%					
Renewal premium (E)		89,630	69,009	64,443	68,215	58,731	30,581
Total Amt		171,112	131,745	123,027	130,228	112,124	58,382
@ 25% amt. of first year premium into equities		20,371	15,684	14,646	15,503	13,348	6,950

Source: Irda, J.P. Morgan calculations.

Debt funds, mainly income funds, have seen substantial redemption pressures over the past two months. October saw a historic INR528B redemption.

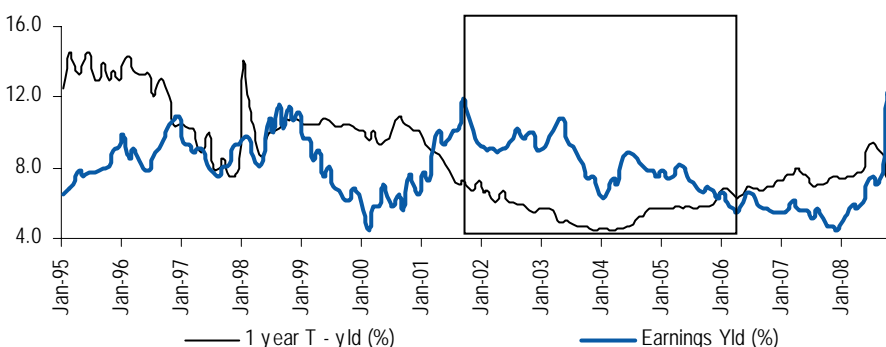
Figure 23: Mutual funds – Equity and debt subscription



Source: AMFI.

Earnings yield increased as equities corrected over November while bond yields declined

Figure 24: Earnings yield and interest rate

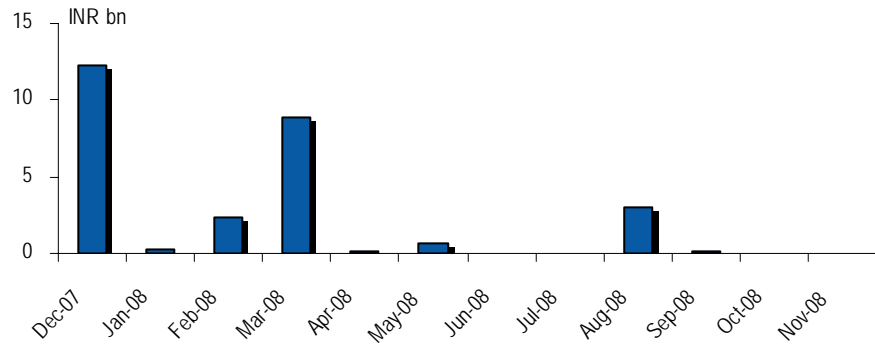


Source: Datastream, MSCI, IBES.

Insider activity remained negligible over the month

Insider activity

Figure 25: Net insider transaction value – MSCI India companies



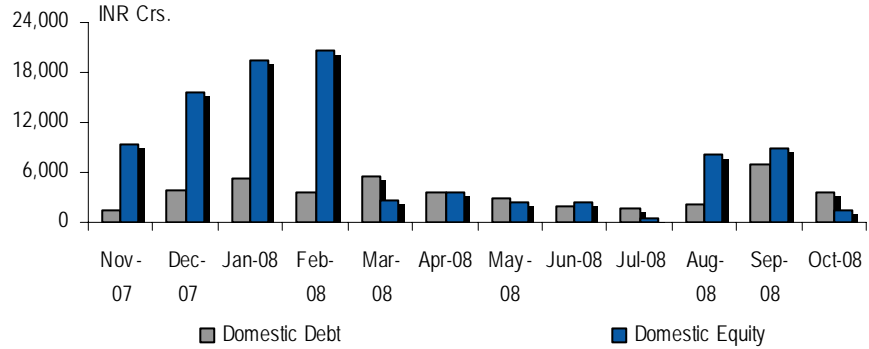
Source: MSCI, Bloomberg, J.P. Morgan.

Equity issuances reduced over October. Fund-raising is mainly concentrated in rights issues and private placements, as investor sentiment remains weak

Equity fund-raising planned for 2008 was almost double that raised over 2007. But weak investor appetite has put a question mark on these plans

Corporate activity

Figure 26: Capital raised from primary capital market - Domestic

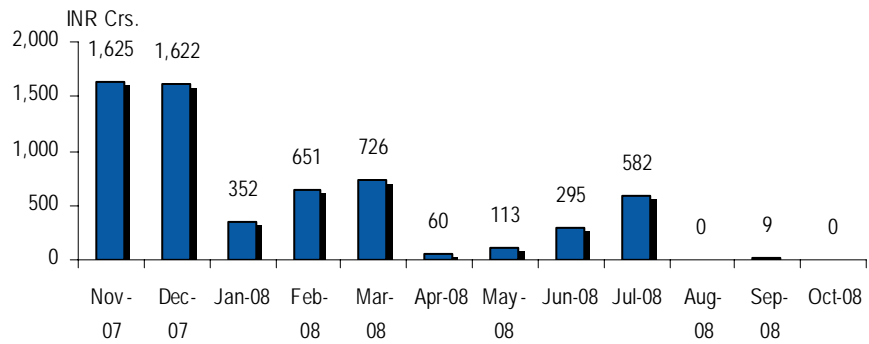


Source: CMIE.

Overseas fund-raising activity remains insignificant too

...the intent to raise funds remains strong, but investor sentiment has not been supportive

Figure 27: Capital raised from primary capital market - Overseas

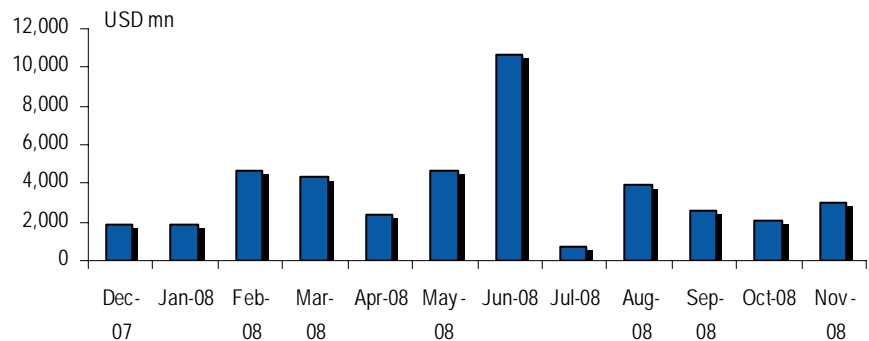


Source: CMIE.

M&A announcements increased marginally over November

Japanese telecom major DoCoMo acquiring a stake in Tata Tele was the key deal of the month

Figure 28: Mergers & acquisitions announced

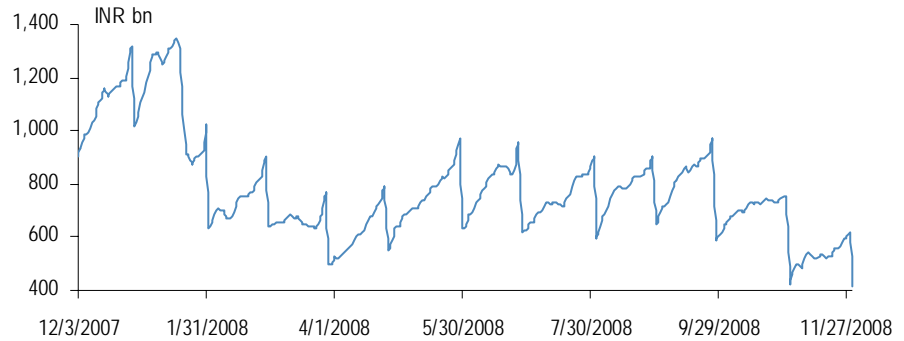


Source: Bloomberg.

Derivatives action

Aggregate F&O open interest further declined over the month, and is substantially off the highs reached early in the year

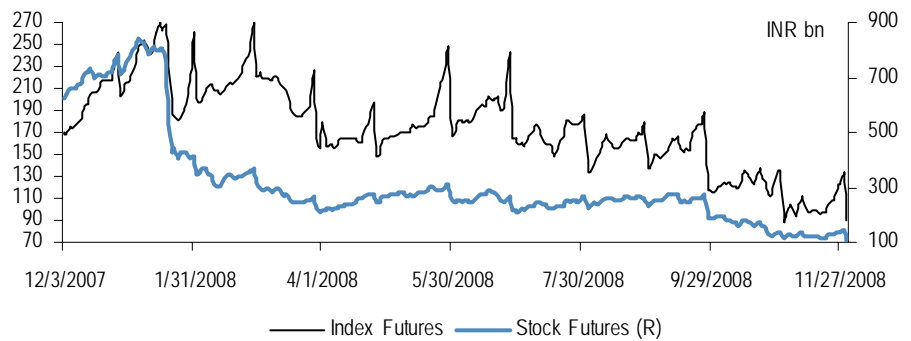
Figure 29: Aggregate F&O open Interest



Source: Bloomberg.

Open interest in equities futures has been weak for a while. Investor interest in index futures also weakened over the month

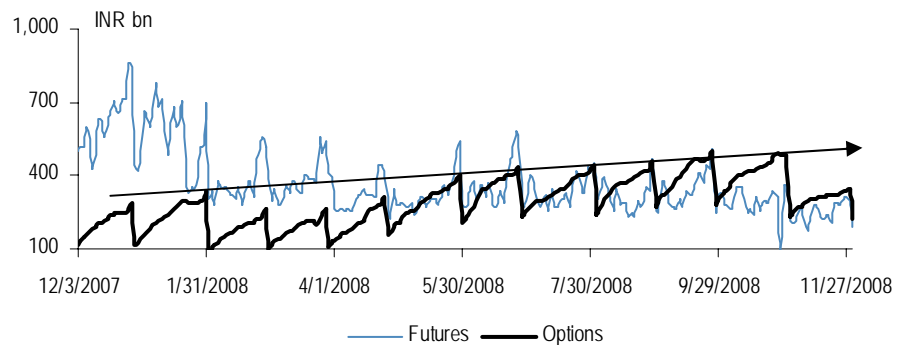
Figure 25: Open interest – Index and stocks futures



Source: Bloomberg.

Open interest in the futures segment has come down over the year. The open interest in the options segment also moderated over the month

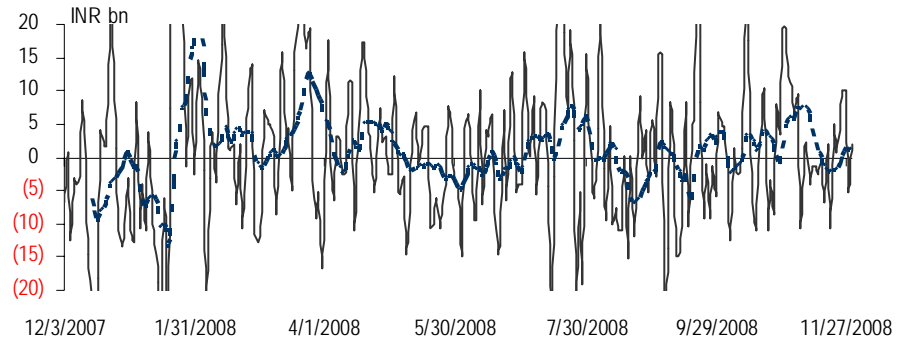
Figure 26: Futures and Options – Open interest



Source: Bloomberg.

FII's turned marginal net buyers towards the end of the month

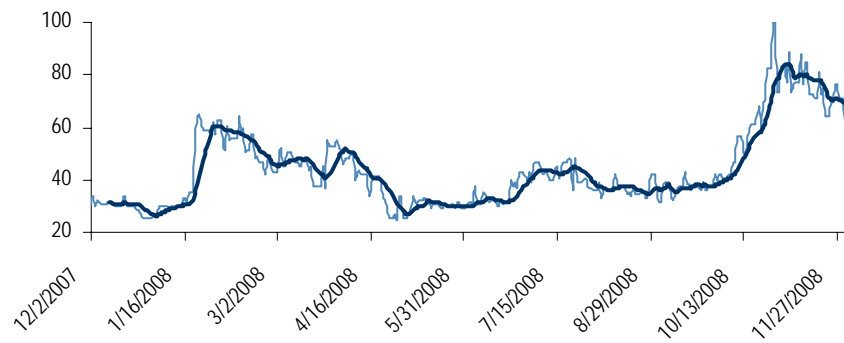
Figure 27: FIIs – Net buy/sell



Source: Bloomberg.

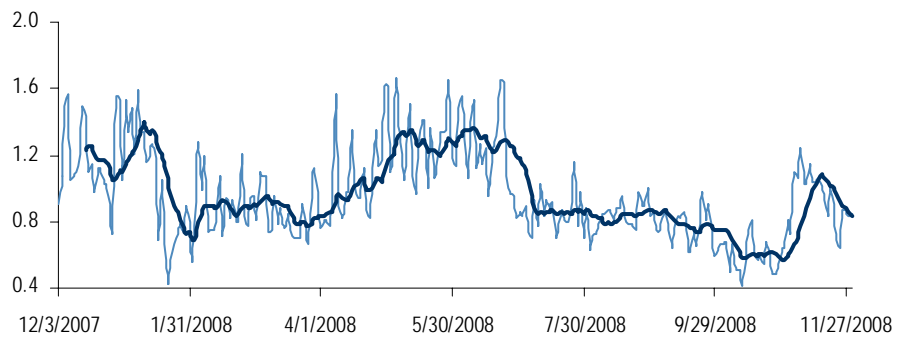
Implied volatility moderated over November but remains at elevated levels

Figure 28: Nifty Index option - Implied volatility (%)



Source: Bloomberg.

Figure 29: Nifty Index option – Put/call ratio



Source: Bloomberg.

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IB clients*	53%	51%	43%
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*Percentage of investment banking clients in each rating category.

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